PARLIAMENTARY COMMITTEE,
Trades Union Congress.

JOINT COMMITTEE ON THE COST OF LIVING

Interim Report

ON

Money and Prices.

Price Ninepence.

LONDON:
CO-OPERATIVE PRINTING SOCIETY LIMITED, TUDOR STREET, E.C. 4;
AND AT MANCHESTER AND NEWCASTLE.

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JOINT COMMITTEE

ON

THE COST OF LIVING.

Parliamentary Committee, Trades Union Congress :—

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MR. A. HORD.

The National Federation of Building Trades Operatives :—

MR. W. BRADSHAW.
MR. G. HICKS.

ARTHUR GREENWOOD,
Secretary.

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INTERIM REPORT

ON

MONEY AND PRICES.

The Joint Committee on the Cost of Living, consisting of representatives of the Parliamentary Committee of the Trades Union Congress, the Labour Party, the Co-operative Union, the Triple Alliance, the Federation of Engineering and Shipbuilding Trades, the National Federation of General Workers, and the National Federation of Building Trades Operatives, has directed its attention in the first place to the various financial and currency problems, both national and international, affecting the cost of living. In this report we deal with the factors which have disturbed the general level of prices, and not with the influences which have been at work to raise the prices of particular commodities. These and other questions coming within our terms of reference will form the subject of a later report.

PART I.

THE PROBLEM.

The General Level of Prices.

The general level of prices depends upon the relation between "money" (i.e., purchasing power) and the goods and services available for sale. If the supply of currency is increased then, with a given volume of goods and services for sale, the value of "money" relatively to goods and services declines, or, in other words, the value of goods and services rises, i.e., prices increase. On the other hand, if commodities and services increase relatively to purchasing power, their value diminishes and prices fall. To put the matter another way, increased purchasing power strengthens the demand for goods and, other things remaining the same, prices rise. If, on the contrary, there are more goods on sale, then competition to dispose of them, if purchasing power remains constant, forces prices down. An expansion of purchasing power, if commodities are not increased, results in increased competition amongst buyers. An expansion of the supply of goods, if purchasing power is not increased, results in increased competition amongst sellers. In the former case prices rise, and in the latter prices fall.

The effects of changes in the volume of currency or goods in general may, of course, be qualified by other factors, but they cannot totally obscure the relationship between the volume of "money" on the one hand and the volume of goods and services on the other. In this report we are not directly concerned with the volume of goods and services—that is to say, with questions of production and allied problems. We are confining our attention to the problems arising out of the supply of "money," or, more concretely, to questions of finance and currency.

Changes in the Volume of Currency.

In the first place, we must consider the changes which have taken place in the volume of currency, and the effect of such changes on the *general level* of prices, as distinct from fluctuations in the prices of specific commodities. At the present time the amount of money in circulation—mainly paper money—both in this and other countries, is enormously in excess of what it was before the war. The reason is not far to seek. The Governments of the countries at war required at their disposal large resources for the purchase of munitions of war

and for the maintenance of large bodies of men taken from productive work. They might perhaps have raised the money necessary, or at least a considerable part of it, by taxation. The British Government did, in fact, levy heavier taxation for this purpose than other belligerent States, though it resorted much earlier than it need have done to the fatally easy alternative of borrowing money. Its taxes, even when they were increased, provided only a fraction of the resources needed to meet the expenditure of war time. The gap between the actual income of the various Governments obtained from taxes and from War Loans representing real savings on the one hand, and the expenditure they were incurring on the other, was filled, to use the words of Professor Pigou, "by concealed levies on the people effected by the manipulation of credit and currency. Resort was, therefore, had to these devices. That is really the root of the whole matter."*

The first and most obvious method of manipulating credit and currency is for a Government to manufacture paper legal tender notes and use them for paying the people from whom it has made purchases. The result is to swell the volume of currency and to raise prices. But a more important factor, so far as this country was concerned, was the resort to loans from the banks. If an individual lends his savings to the Government there is merely a transference of purchasing power. If, however, a bank provides the Government with what is in effect an overdraft new credit is manufactured. The British Government raised loans from the Bank of England and the Joint Stock Banks, which resulted in the inflation of prices. The relations between these loans and prices may be seen by considering the case of a Bank of England loan. The Government secured in the books of the Bank large credits. It then proceeded to meet its various obligations by drawing cheques upon the Bank of England. These cheques were passed into the banking accounts of the Government's creditors, e.g., contractors and others doing business or having dealings with the Government, and increased their purchasing power. But the effect upon prices went beyond this. The balances of the banks were increased, and, therefore, the proportion of reserves to liabilities raised, so that they were able to increase their investments in Treasury Bills. In other words, credit was further expanded on the basis of the loan of the Bank of England to the Government. The effect of this expansion of credit was further to raise prices.

The process outlined above was an alternative to paying Government debts by manufacturing paper money. There is, nevertheless, a large circulation of notes in this country at the present time. This arose partly because gold was withdrawn from circulation and notes substituted for it, and partly because the rise in prices created a need for more currency.

* "The Problem of the Currency," by Professor A. C. Pigou.—("Contemporary Review," February, 1920.)

The Results of Abnormal Currency Expansion.

The expansion of currency has been a marked feature of the past six years the world over, and the results, though varying in degree, have been much the same in all countries. The situation is summarised in a recent publication of the League of Nations:—

> " (1) All currencies have depreciated in terms of commodities. Even those countries, such as Argentina, which have escaped the necessity of special expenditure for military purposes, have failed to escape from a rise in commodity prices. In fact, neutral countries have been more or less compelled to endure many of the financial and economic ills which have fallen upon the belligerents.
>
> " (2) Most currencies have depreciated in terms of gold.
>
> " (3) Gold itself has depreciated in terms of commodities.
>
> " (4) There is a remarkable relation between the expansion of currencies and the rise in commodity prices. . . . .
>
> " (5) In certain cases, such as that of Germany, there is a great disparity between the internal and external commodity values of the currency.
>
> " (6) Everywhere currency and exchange disorder is hampering trade and retarding reconstruction. In some countries it is a prime factor amongst those which are causing a breakdown of the economic and social system."*

" The last of these results," we are told, " is incomparably the most serious. . . . The trouble is now twofold. In the first place, all currencies have lost their stability and some are almost valueless. In the second place, the very countries which, like Austria, are short of essential commodities, are unable to obtain credit. Instability of currency helps to deprive these countries of the possibility of obtaining credit, and lack of credit prevents the stabilisation of the currency."†

The Necessity for National and International Action.

The problem which confronts us is thus one which calls for both national action and international co-operation. As regards the former, the need is for a policy which will bring to an end inflationist methods of financing Government expenditure in the various countries, whether by printing paper money or borrowing from banks.

But even if each nation were to use every endeavour to grapple with its financial and currency problems—and it is essential that all nations should—international action will be necessary. The Secretariat of the League of Nations suggests that " it is perhaps by

* "Currencies After the War: A Survey of Conditions in Various Countries." Compiled under the auspices of the International Secretariat of the League of Nations. (Harrison and Sons, 1920.) Pages viii. and ix.

† Ibid, p. 9.

international co-operation alone that we can now hope to stay the breakdown of currency and credit which over large areas is rapidly developing into a disaster of the first magnitude.* If the cautious word "perhaps" were deleted we should subscribe whole-heartedly to the view expressed in the foregoing sentence. *The economic restoration of the world, in our judgment, depends upon international co-operation.*

Currency and Prices During and Since the War.

It has been pointed out above that there is a close correspondence between the expansion of currencies and the rise in commodity prices. The following table, taken from an official document,† serves to illustrate this, and also to show the relative growth of money in circulation in certain countries:—

COMPARISON OF EXPANSION OF CURRENCY WITH RISE IN PRICES.

ESTIMATED PERCENTAGE OF 1913.‡

	Currency of all kinds. 1913=100.	Wholesale prices. 1913=100.	Retail prices of food. 1914=100.
United States (March, 1920)	177	253.0	196
United Kingdom (March, 1920)	250§	321.8	235
Switzerland (December, 1919)	253	—	237
Denmark (January, 1920)	255	—	251
Japan (October, 1919)	274	266.3	—
Sweden (March, 1920)	275	354.0	291
Netherlands (February, 1920)	290	—	199
Norway (February, 1920)	305	—	294
France (February, 1920)	400	522.4	Paris 297
Italy (December, 1919)	565	452.6	252

The actual statistical relation between the volume of currency and prices, as Mr. J. M. Keynes has said, "is in so close a conformity with the predictions of theory as to surprise even theorists, having regard to the many disturbing factors of the present."‖

It has been shown that the rise in prices in this country followed the increase of the notes issued by intervals of about three months. Statistical investigation in the case of both Canada and the United States also showed that the rise in prices followed upon the issues of notes.

It is not, however, universally agreed that the expansion of currency is the main factor in the rise of prices. It is sometimes urged that the cause is to be found mainly in the shortage of goods,

* Ibid, p. 13.

† "Statement of Currency Expansion, Price Movements, and Production in Certain Countries." Cmd. 734, 1920, p. 7.

‡ The fact that retail prices of food have risen less than general wholesale prices is in part attributable to the control of prices by Governments extending, in certain cases, to the maintenance of retail prices below cost of production by means of subsidies.

§ In the case of the United Kingdom, the circulation at the end of March, 1920, is compared with the circulation at the outbreak of the war.

‖ "Economic Journal," December, 1919.

i.e., in deficient production. Mr. Goodwin, manager of the C.W.S. Bank, who gave evidence before the Committee, supports the latter view. Professor Pigou, another witness, took the contrary view, whilst Mr. Hugh Dalton,* in a memorandum prepared for the Committee, suggests that " the increase of currency rather than the decrease of goods is the dominant cause of the rise of prices." *We have arrived at the conclusion that, so far as the rise in the general level of prices is concerned, the expansion of currency must be regarded as the main factor.*

It is clear, of course, that a shortage of production of commodities, brought about directly or indirectly by the war, must have tended to raise the general price level. But, as Professor Pigou explained to the Committee, " other things being equal, a shortage of things in general cannot raise prices in general more than in proportion to the shortage. It is true that a 10 per cent. shortage of a particular thing might easily raise its prices by 100 per cent., but if this happened there would be less money available to spend on other things, and so their prices would tend to go down. A small fall in each of a great many things would match the large rise in the one thing. Since, therefore, there is reason to believe that the shortage of things in general, though large absolutely, is, expressed as a percentage, small, the shortage of things is probably not responsible for a large proportion of the general rise of prices."

We are in agreement with this reasoning. Various estimates have been made as to the fall in the world's production of commodities as a whole. Some suggest that it has been about 10 per cent., other estimates put the figure at 20 per cent. We believe the latter estimate to be nearer the mark. It is obvious, however, that production has not diminished by a proportion which would account for the world rise in prices. The dominant cause must, therefore, be found in the " money side " of the problem.

It follows that the first step is to deal with the currency and financial aspects of prices. This is not to say, however, that greater productivity over the whole world is not essential. It is, indeed, vitally important, but it will operate only gradually, and in any case its full effects cannot be obtained so long as Governments pursue an inflationist policy of financing themselves and so long as currency stability particularly on the Continent, is not attained.

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* Memorandum on " The Cost of Living as Affected by the Government's Currency Policy," by Hugh Dalton, M.A., Lecturer at the London School of Economics.

PART II.

BRITISH POLICY.

The Future of Prices.

This brings us to a general statement of what we deem to be the wisest policy. We do not think that a rapid fall of prices to something approaching the pre-war level is possible. We are, indeed, convinced that a heavy and rapid drop in the general level of prices would be accompanied by unfortunate results. Currency operations directed towards a restoration of pre-war gold prices would create great difficulties of readjustment, similar in character to those which accompanied the rise in prices. This and other countries have adapted themselves in a measure to the drastic alteration in the price level, and readaptation to meet a large opposite movement of prices would lead to confusion and worse. A large reduction in the volume of currency would result for a time in dear money, the restriction of credit, and the contraction of trade activity and industrial stagnation. "These things must happen," as Mr. H. D. Henderson has informed us in a memorandum prepared for the use of the Committee,* "before the price of such commodities as are measured by the 'Economist' index number can begin to fall. But that is not the end. Before the fall can work round to retail prices, to the cost of living, unemployment and reductions of wages must have diminished the spending power of the working class. For until the demand for these things is diminished there is nothing to reduce their price, and no diminution of profits is likely to affect appreciably the consumption of the necessaries of life by the well-to-do." At the present juncture, however, an increase in the production of all useful things is one of the world's most urgent needs. "In these circumstances," continues Mr. Henderson, "deliberately to bring about a curtailment of production, a restriction of industrial activity (and this is what a policy of drastic deflation must mean) would involve a preposterous paradox. So preposterous, indeed, that it may almost seem incredible. Surely, it may be suggested, there can be no danger of a crippling of industry amid the present world hunger for goods. But would this be anything more than an extreme instance of a phenomenon that has constantly occurred? At no time can it be said that the production of goods has been adequate to meet the real needs of mankind—at all times, if demand is to be measured by human needs, there has been a large unsatisfied demand for food, and clothes, and house-room, and every necessary of life. None the

* Memorandum on "Currency and the Cost of Living," by H. D. Henderson, M.A., Lecturer in Economics, Clare College, Cambridge.

less we know that industry has been frequently paralysed by lack of orders, and we have learnt to distinguish between a real and an effective demand. Nor, after all, is there anything to be surprised at in the situation? One of the penalties we must pay for an economic system, which is completely unorganised in the sense that there is no attempt to correlate means to ends, that there is no one whose business it is to see the right quantities of boots and shoes, or bread or steel, are produced, is that we must be prepared to find that the stability of this system is rooted in instability, and that its equilibrium rests on the fact that any departure from that equilibrium is corrected by the harsh checks of unemployment and distress."

A second feaure peculiar to the present situation needs to be borne in mind. The shortage of useful things is especially marked in the case of the commodities constituting the principal items of the cost of living. The existence of various controls and subsidies and the absence of effective competition as regards bread, coal, and house-room, for example, have kept down the price of these things below that at which they would otherwise stand. It would consequently take some time before diminished purchasing power reduced the effective demand for them and resulted in lower prices. In these circumstances a fall in the general price level would take far longer to affect the cost of living appreciably than it would if rents, the cost of bread, etc., had not been under control.

If there were a rapid fall of prices due to currency restrictions, employers would argue (and in many cases with truth) that they could no longer afford to pay the existing rates of money wages, and, as trade would be depressed owing to the contraction of credit, the Trade Unions would be faced with the alternatives of lower wages or unemployment. And amid this industrial chaos, the needs of the world for the produce of British mines, factories and mills would not be satisfied.

A considerable fall of prices in this country alone, however, is impossible. The United Kingdom cannot act with complete independence. The raw materials of some of its greatest industries come from abroad. The prices of these materials are world prices, and the prices of commodities manufactured from them—woollen and worsted cloths, cotton goods, boots and shoes, and so forth—would inevitably be based upon the cost of the raw materials. There is little likelihood, in view of the existing shortage of some materials and the unsatisfied demand for products made from them, that world prices will drop anywhere near the pre-war level, and unless they do prices in this country cannot fall to that extent.

The broad policy which we regard as desirable is one which will deflate currency and credit sufficiently to overcome the present depreciation of sterling, relying upon the gradual expansion of world production (which must be assisted in all possible ways) to bring about a steady reduction in world prices by normal means.

This policy puts aside, for the time being at least, the possibility of any return to pre-war prices. There is, however, no special sanctity attaching to the prices prevailing in 1914. As Mr. McKenna said in his evidence before the Committee, "Why 1914? Why not 1814?" We believe that every effort should be made to establish an adequate standard of life for the people on the basis of existing prices. We look to alterations in the industrial system and the increased productivity of the world to bring about a progressive elevation of that standard. *We think that the present index numbers of prices should be discarded, and that the prices prevailing at the period of the Armistice in 1918 should be taken as the basis for the calculation of future price changes. This would introduce a reality into the present index number of prices which they do not at present possess.**

The British Currency Problem.

We may now consider the British problem so far as currency is concerned. There has been a depreciation of gold relatively to goods, or, to put it another way, there has been a rise in general gold prices. But there has also been a depreciation of paper money in terms of gold. A pound note will not buy the amount of gold contained in a sovereign, and British bills of exchange will not sell in America at their par value. The price of an ounce of gold bullion on July 16th in terms of paper money was 106s. 6d. as compared with the pre-war price of 85s., based on the gold content of a sovereign. The depreciation of our paper currency, therefore, in terms of gold is about 20 per cent. The American rate of exchange on July 17th was 3.87$\frac{7}{8}$. That is to say, a paper pound exchanged for 3.87$\frac{7}{8}$ dols., whilst the par of exchange, i.e., the value of the gold sovereign in terms of dollars, is 4.87. This is accounted for chiefly by the depreciation of the paper pound in terms of gold, though also to some extent by an adverse balance of trade. The result of this adverse exchange is that goods are obtained from the United States at a higher price. We were informed by Mr. Goodwin, of the C.W.S. Bank, that the effect of the present rate of exchange with the States was to add 5d. per lb. to the price of imported American bacon.

It is clear that the restoration of the depreciated currency to full parity with gold would have a substantial effect upon prices. To cancel the depreciation of the currency, in the sense in which we are here using the term, would be to restore the gold standard and the gold exchange standard currency. This can be brought about only by a reduction in the volume of money in circulation.

By a Treasury minute† the Chancellor of the Exchequer at the end

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* This question will be discussed further in a later Report.

† Treasury minute dated 15th March, 1919, directing that the actual maximum fiduciary circulation of currency notes in any year shall be the fixed maximum for the following year.—Cmd. 485, 1919.

of 1919 adopted one of the recommendations contained in the Final Report of the Committee on Currency and Foreign Exchanges after the War, in which it was suggested that a maximum limit should be imposed on the issue of currency notes under the Currency and Bank Notes Act, 1914, and that the actual maximum fiduciary circulation of currency notes in any year shall be the fixed maximum for the following year. This figure for 1919 was £320,600,000, and in 1920, therefore, the maximum issue of currency notes by the Bank of England (except against gold and Bank of England notes) will be this amount. At the present time the fiduciary issue is very little short of this maximum, and is actually in excess of what it was twelve months ago (July, 1919).

It is necessary that the Treasury minute should be superseded by legislation regulating the conditions of issue of notes by fixing an absolute and regularly decreasing amount which the fiduciary issue must not exceed. It was suggested to us by Mr. Hugh Dalton that the fiduciary issue should be reduced at the rate of £2,000,000 a week. We are not certain, however, whether this would prove practicable, but we realise that if difficulties are to be avoided the reduction must be gradual. Nevertheless, it seems to us that the amount of the fiduciary issue should be gradually and periodically reduced, by stated amounts at stated intervals of time, until the depreciation of the British paper currency in terms of gold disappears. At the same time, *it is of the utmost importance that the Government should cease the practice of resorting to bank credits as a means of national finance.*

The Floating Debt.

We have given consideration to the question of the floating debt. This debt consists of Treasury bills, amounting at the present time to £1,059,000,000, and Ways and Means advances amounting to £205,000,000. In so far as the floating (or short term) debt is taken up by the banks, it involves credit inflation. We were informed by Mr. McKenna, however, that it was mainly held by the public and not by the banks. The position in his opinion gave no cause for alarm. But the floating debt may, we think, be a real source of danger. It consists essentially of short term advances made to the Government, and if the joint stock banks, or the public making them, did not renew them when the Government needed resources to meet obligations which had fallen due, it would be driven to resort to the Bank of England to obtain credits which, as we have shown above, would increase the volume of currency and raise prices. The only alternative would be for the Government to obtain a renewal of its short period loans by offering high rates of interest, a course which is obviously open to serious objection. *We think, therefore, that steps should be taken to extinguish the floating debt, or a large portion of it, and to fund the remainder.* We are not concerned in this Report with the question of taxation, and therefore postpone the

further consideration of the extinction of debt to a later report.* But we would point out here that early steps are necessary to reduce the total volume of war taxation in order to relieve the community of the burden of the high rates of interest payable on the Government loans. The action of the Government in borrowing money at high and increasing rates of interest (though it adopted the conscription of men) must be held responsible in some measure for the rise in prices.

The Banking System.

In our investigations into financial operations and the currency system in relation to the cost of living, we were led to consider the banking system. We realise that any immediate re-organisation which might be undertaken would be unlikely to affect the present problem of prices; but on a long view, we cannot avoid the conclusion that the amalgamation of banks, which has been a marked feature of recent years, has placed the control of the financial machinery of the country in the hands of a small number of people. The whole banking business of the country now practically rests with five joint stock banks. We are informed that there is keen competition between these amalgamations. In so far as competition exists, however, it supplies the banks with a powerful motive for co-operation. The danger of a "money trust" is a real one which has been recognised by the Treasury. No bank amalgamation can now take place without its consent.

The prevention of amalgamation, however, may not be in the national interest. We have no doubt that industry and commerce have on the whole benefited by the unification which has taken place in the banking world. It has been an essential corollary of large scale enterprise, and it has mobilised capital resources and credit more effectively.

It does not appear to us a far-sighted policy to hamper further amalgamation; the real danger, it appears to us, is not the elimination of competition but the exercise of a powerful monopoly by a group of private individuals. The fact that Treasury approval is now a condition of amalgamation is an admission of the need for control, presumably because of the fundamentally important character of the banking service; in our view, the control should be complete.

We have observed that there is an increasing tendency in the direction of appointing industrial and commercial magnates to bank directorates. We have also observed the growing part which financial interests are beginning to play in the direction and control of industry. The relations between industry and the banks are becoming gradually closer. In other words, the whole economic mechanism is passing under the control of a relatively small number

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* We may observe, however, that Sir George Paish, Professor Pigou, Mr. F. W. Pethick Lawrence, and Mr. J. A. Hobson supported the proposal for a capital levy. Mr. McKenna, on the other hand, regarded it as impracticable, and expressed the view that taxation necessitating valuation was unsatisfactory.

of people who wield enormous power. The triple alliance of the great joint stock banks, the big financial corporations and trustified industries is creating a situation of the utmost gravity from the broad national point of view.

The banking organisation of the country differs from every other "industry." The total paid up capital of the five large banks—"the big five"*—amount to rather over £43,000,000, but their aggregate deposits amount to over £1,548,000,000. They are the custodians of the surplus resources of the people, resources which they utilise for the benefit of the shareholders. We are not denying that the banks perform a necessary and valuable service in mobilising these surplus resources and putting them to productive use; but we would point out that the function is one which, under modern conditions, ought not to be left to virtually uncontrolled private agencies.

During the period of re-establishing industry and commerce in the world, the relations between the Government and the banks are bound to be intimate. The Bank of England, though in fact a private institution, has acted, during and since the war, largely under the instructions of the Government, and there have been close relations between the Bank of England and the joint stock banks and the Treasury. It could not well be otherwise, for the reason that the basis of the banking system is the national credit, and the national credit is the credit of the nation's population.

The stock-in-trade of the banks is derived from the combined resources of the people as a whole. Their funds are the people's funds, and the realisation of democratic ideals necessitates that the banks should be popular institutions.

We suggest, therefore, that the banks should be brought under the control of the Government. The banking functions of the Post Office, which have little in common with its main activities, could then be transferred to the national banks.

Government Expenditure.

Every witness who appeared before the Committee emphasised the enormous importance of Government economy. Some witnesses drew a sharp distinction between expenditure of a purely unproductive character, and expenditure which was ultimately productive. We do not wish to see any reduction of Government expenditure on national services such as health and education, nor could we subscribe to any policy of withholding generous treatment to disabled ex-Service men, or of refusing adequate pensions for the aged (which are at present much too low). But *we feel strongly that the enormous*

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* The London Joint City and Midland Bank, Lloyd's Bank, the London County, Westminster and Parr's Bank, the National Provincial and Union Bank of England, and Barclay's Bank.

expenditure for military and naval purposes in which the Government is still involving the nation tends to perpetuate high prices, for it withdraws both capital and labour from productive uses.

The Circulation of Gold.

Before we turn to the question of international policy, we would refer to the question of the use of gold. Now that the public have become accustomed to the use of Treasury notes, we see no reason why gold coins should again be put into circulation, though the notes would need to be based on gold held by the national bank.

PART III.

INTERNATIONAL POLICY.

The International Situation.

As regards the international side of the problems of finance and currency, we feel that the situation is far graver than the situation at home. We have already expressed our view that international action is vitally necessary for the restoration of the machinery of exchange and the rehabilitation of the economic systems of the continent. Sir George Paish informed us that the decline of production in Europe amounted to between 30 per cent. and 40 per cent. On the other hand there has been excessive currency expansion and a corresponding rise of prices. The present position is chaotic. Economic restoration of the devastated areas and the re-establishment of productive industry elsewhere in Europe are prime needs. But the depreciation of currency and the collapse of the foreign exchanges, together with the prevailing uncertainty as to the financial clauses of the Peace Treaties, have resulted in a lack of credit, without which the economic situation cannot be remedied. Moreover, the state of war which still exists between many countries and the absence of real peace between others are further obstacles to currency stability and the resumption of trade activity.

The Need for Peace.

It is obvious to us that *the first essential is the establishment of peace*. It is high time that the ex-enemy countries were brought fully within the confederation of nations, and that peace was concluded with Russia. Until these steps are taken economic restoration, on a scale sufficiently large to ensure the necessary productivity, is impossible. In the case of Russia, we are depriving Western Europe of the commodities which they need, and the Soviet Republic of goods which they are unable to produce for themselves. Russia, as Sir George Paish reminded the Committee, is the chief producer of cereals for human consumption. Under ordinary circumstances, a bad wheat crop in one part of the world is usually counterbalanced by a good crop in some other wheat-producing area. But without Russian supplies to draw upon, we are running a very grave risk of a serious food shortage, and every day that the resumption of trade with Russia is delayed renders the food situation next year more perilous. Unless, within the next few weeks, Russia is given every assistance to increase her acreage under wheat by the provision of agricultural machinery, transport equipment, and other urgent necessaries, the prospect of a wheat crop next season sufficiently large to meet the requirements of the people of this and other countries will entirely

vanish. It is, therefore, both here and abroad against the interests of the mass of the people that political prejudices and the spirit of military adventure should stand in the way of immediate peace with Russia and the establishment of the fullest trade relationships.

Indemnities.

The second essential item in any comprehensive international policy must be the imposition of fixed and reasonable indemnities. All the witnesses whom we questioned on this point were in agreement as to the desirability of this step. We do not think that the economic conditions of Austria are such as to justify expectations of receiving any indemnity whatever from her. In the case of Germany, payment is not impossible, if her liabilities are defined and reasonable in amount having regard to her circumstances.* With the gradual growth of industrial activity and the free exchange of goods she would rapidly recuperate, and be able to make her contribution to the price which the world is paying for the Great War.

It is possible that if the total German indemnity were fixed at a reasonable figure, Germany would then be able to obtain the credit necessary for her economic reconstruction, without the intervention of any international machinery. But it is far otherwise with other European countries. Some of our allies are in debt to the United Kingdom, but they are unable even to meet the interest which is due. They are not even able to pay for the goods which they import, and the result is that the United States and Britain are both exporting commodities without present payment.

Reform of Continental Currencies.

It is obvious that *each country must endeavour to restore its currency to more normal conditions.* There appears little likelihood, however, of a general return to a gold standard in the pre-war sense. On the other hand there would be no stability in exchange rates, if some countries continue to carry on their currency systems with inconvertible paper bearing no real relation to gold. *We suggest that the first need in all countries is to cease financing Government expenditure by means of bank loans, to recover their paper money held abroad, and to stop further issues of paper money.* When these measures have been accomplished, an attempt should be made to stabilise foreign exchange rates (or more accurately to reduce the fluctuations to narrow limits). This can be done only by establishing in each country a new parity between gold and currency. It would, of course, be desirable to restore the pre-war parity if it were possible, but this, at least in some European countries, is utterly impracticable, and even if it could be brought about, it would only be as the result of an enormous contraction of currency, very high

* Mr. Keynes considers that "£2,000,000,000 is a safe maximum figure of Germany's capacity to pay."—("The Economic Consequences of the Peace," p. 186.)

rates of interest for money, serious industrial depression, and widespread unemployment. On the other hand, for any country to accept a par rate of exchange below the pre-war standard would be to accept a depreciation of its currency, which would react upon its credit in the world. Of the two evils, *we are convinced that each country should establish a new parity bearing a close relation to economic facts.* There should therefore be an international agreement under which each country should undertake in the first place to proceed, as rapidly as circumstances will allow, with the deflation of its currency or at least to cease from further inflation. Then the parity which exists when the deflation has taken place or when inflation has been ended should be taken as the new parity. Where the position disclosed that a country, e.g., the United Kingdom, was within easy reach of re-establishing the pre-war parity between currency and gold, efforts should be made to return to this parity. On the Continent, however, as for example in Germany and Austria, though the appreciation of their currency would bring a nearer approach to the pre-war parity than the present foreign exchange quotations would lead one to believe, there is no doubt that the establishment of the old par is impossible. The whole problem is one of great complexity, and *the policy we have suggested should be worked out in detail by an expert commission of the League of Nations.*

The Use of Barter.

These steps, however, will not be sufficient. It will be impossible to stimulate the tiny trickle of goods from many countries, especially those in Central Europe, so long as the exchange rates are as meaningless as they are at present. We think, therefore, that whilst other measures are being put into operation, and with a view to stimulating production and trade, *the method of direct barter (which has already been adopted to some degree) should be widely extended.* It would, we believe, be more effective if each Government itself carried out transactions of this character, or alternatively delegated them to some organisation which should act for the nation. With the breakdown of the foreign exchange system and the serious lack of credit on the Continent, some immediate and direct means must be found for the exchange of goods.

An International Loan.

Several proposals have been made for the floating of an international loan. We ourselves incline to the view that *the League of Nations should issue interest bearing bonds which it should distribute as the loan agreed upon to the borrowing countries.* The apportionment of the international loan amongst the various nations requiring Government assistance would be a matter for the League of Nations. The borrowing countries would sell the bonds they held to the public, or utilise them directly for the payment of goods purchased abroad.

The allocation to the different Governments of their quota of the loan would, of course, be based upon relative needs as regards immediate requirements for consumption, and requirements for productive purposes, taking into account the effects which a loan to a particular country would have upon the general economic restoration of Europe.

The League of Nations would need to lay down the conditions on which loans should be granted. It is imperative that any Government provided with a loan should undertake a reorganisation of its currency as far as practicable. A loan might assist this, but independent measures, as we have suggested above, would need to be introduced. It would also be vital to the purpose of an international loan that the League of Nations should set out the form of expenditure to which the resources provided should be devoted. Obviously the whole of the loan should be utilised for the purposes for wihch it would be provided, i.e., for the purchase of necessary food supplies and raw materials, and for the re-equipment of farms, factories, mines, and transport services. The new resources of the borrowing Government should not be directed to military purposes, for example, or utilised in such a way as to enable a State to undertake military expenditure which, but for the loan, it could not have undertaken. Foreign investment by the inhabitants of a borrowing State would need to be prohibited. *Ex hypothesi*, a nation in need of a loan would be without the means of investing capital abroad. Other considerations would also need to be taken into account. Here again, owing to the complexity of the questions involved, *we think that there should be an expert commission appointed by the League of Nations to work out in detail the conditions which should accompany the grant of an international loan.*

We consider that the international loan floated for purposes of economic restoration might, as and when it was redeemed, be utilised for other international purposes approved by the League of Nations.

The effect of the proposals we have made above would be twofold. They would assist in restoring and stabilising foreign exchanges and improving national currencies; whilst, on the other hand, they would assist the recovery of industry and stimulate productivity.

Summary of Conclusions.

Our main findings and recommendations may be summarised as follows:—

1. The rise in prices is due more to currency expansion than to contraction of production.

2. The first step, therefore, is to deal with the expansion of the currency in this and other countries and to deflate it, where this is possible, to an extent which will eliminate the depreciation of currency in terms of gold.

3. Such a process will not restore prices to the pre-war level, but in this country it would mean perhaps a reduction of the general level of prices by about 20 per cent. It would also cut at the root of the automatic rise of prices due to currency influences.

4. We look to the development of productive capacity all over the world to bring about ultimately a substantial fall in prices.

5. An attempt to secure a fall of prices to the pre-war level by a drastic restriction of the currency would, we hold, result in widespread unemployment, and, most probably, in a considerable fall in wages. By the operation of a steady improvement in productivity (through the participation of all countries in the trade of the world, the improvement of methods and machinery, and a far-reaching reorganisation of industry) the standard of life of the people would be maintained and automatically raised as prices fell.

6. We are of opinion that the present index numbers of prices should be superseded by new index numbers based upon the prices prevailing since the Armistice. (We shall give detailed consideration to this question in a later Report.)

7. In the interval, the adaptation of existing conditions to the present prices should be perfected.

8. As regards the currency question in this country, we suggest that—

(a) Legislation is necessary to regulate the conditions of issue of notes by fixing an absolute amount which the fiduciary issue must not exceed, this amount to be gradually and periodically reduced until the depreciation of British paper currency in terms of gold disappears.

(b) The Government should cease entirely to resort to bank credits to meet expenditure.

(c) The floating debt should be wholly or largely repaid, the remainder, if any, being funded.

9. We are of opinion that the banking system of the country should be publicly controlled.

10. It is essential that Government expenditure upon military and naval enterprises should cease.

11. As regards the international aspects of the problem of high prices, we think that—

(a) The re-establishment of peace throughout the world is a prime essential.

(b) War indemnities should be defined, and reasonable in amount.

(c) Every country should be required to take all possible steps to rehabilitate its currency.

(d) In countries where a return to the gold standard is impracticable a new parity of exchange should be established.

(e) Until the machinery of exchange is re-established, the import and export of goods between different countries should be conducted, where other methods are not possible, by means of direct barter.

(f) An international loan should be floated by the League of Nations (under conditions laid down by the League) in order to provide impoverished countries with a means of restoring their productive capacity.

Conclusion.

We think it necessary to point out, before closing this Report, that we do not wish to imply that the problem of high prices is an insoluble one. It is true that we do not conceive a very considerable fall of prices as practicable in existing circumstances. But with a change of these circumstances, prices might fall substantially. We are convinced that the high cost of living is due largely to the defects and weaknesses of the industrial system. We accept the fact, as expressed by Mr. H. D. Henderson in his Memorandum, that "the present dilemma, in which it is virtually impossible to check the tide of rising prices, without paralysing trade and industry, represents one more instance of the growing instability, inadequacy and disintegration of the capitalist system." We have tried to avoid making proposals which would create industrial dislocation, or at least to ensure that dislocation should be reduced to a minimum. It is a powerful indictment of the existing industrial order that, apart from drastic and fundamental changes in its structure and purpose, the way to lower prices lies in the first instance through measures which might temporarily aggravate the evil. But this makes it all the more necessary for us, when we come to deal with the other side of our problem—the demand for and supply of goods and services—to consider what antidotes there may be to the possible aggravation of high prices due to the working of the industrial system.

We wish to extend our thanks to Mr. J. T. Day (Editor of the "Shoe and Leather Record"), Mr. Thos. Goodwin (manager of the C.W.S. Bank), Mr. J. A. Hobson, M.A., the Rt. Hon. Reginald McKenna, Mr. F. W. Pethick Lawrence, M.A., Sir George Paish, and Prof. A. C. Pigou, M.A., who gave evidence before the Committee, and to Mr. Hugh Dalton, M.A. (Lecturer at the London School of Economics), Mr. H. D. Henderson, M.A. (Lecturer in Economics, Clare College, Cambridge), and Sir James Wilson, K.C.S.I., who submitted memoranda to the Committee. All these gentlemen gave us the benefit of their special knowledge on a series of abstruse and difficult questions. To those whose views we do not share and have not accepted, we are under a special obligation, for they have tended to correct our own conclusions. We have endeavoured to conduct

the first stage of our inquiry in an independent spirit and with a single eye to the welfare of the nation as a whole, and we ask that this report should be considered by the public as a sincere attempt to formulate practical proposals towards the solution of one of the gravest problems of our time.

(Signed)

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August, 1920.

CO-OPERATIVE PRINTING SOCIETY LIMITED
TUDOR STREET
LONDON, E.C
ALSO MANCHESTER
AND NEWCASTLE.